



# The Real Estate ANALYST

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A concise easily digested periodic analysis based upon scientific research in real estate fundamentals and trends. Constantly measuring and reporting the basic economic factors responsible for changes in trends and values. Current Studies. Surveys. Forecasts.

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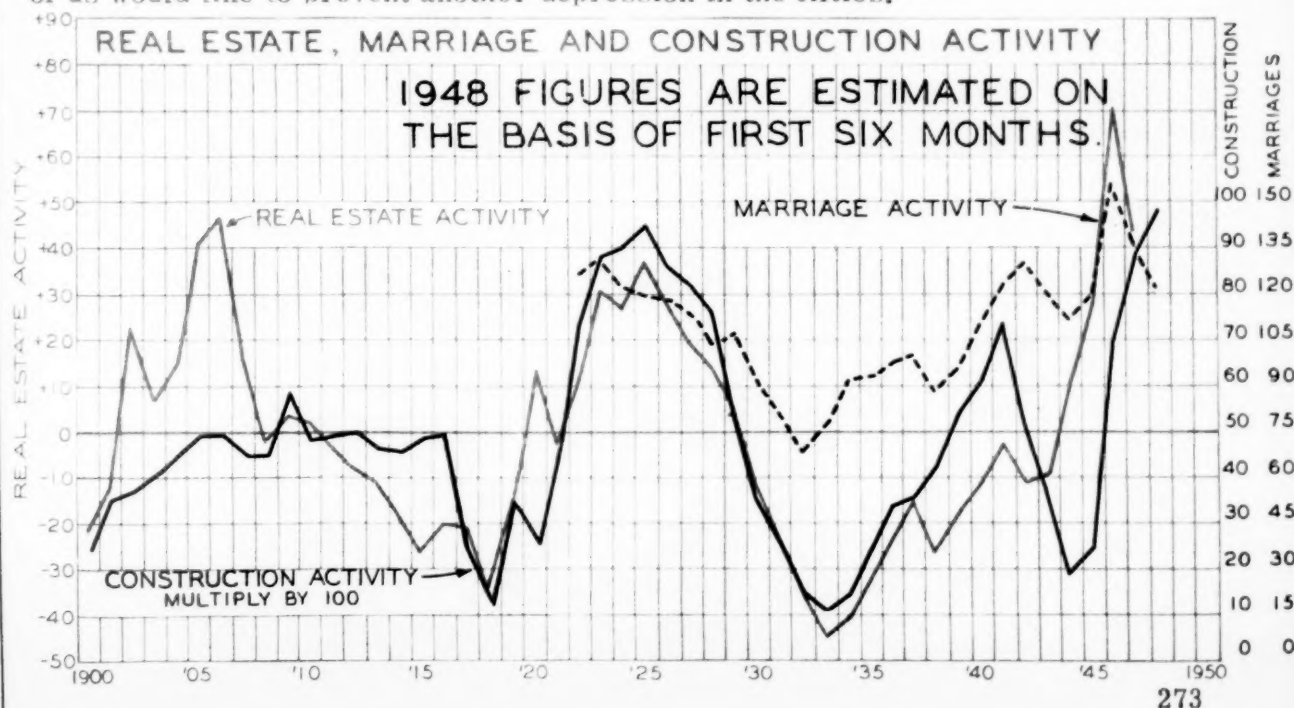
REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS

Number 33

## THE BOOM SLOWS DOWN

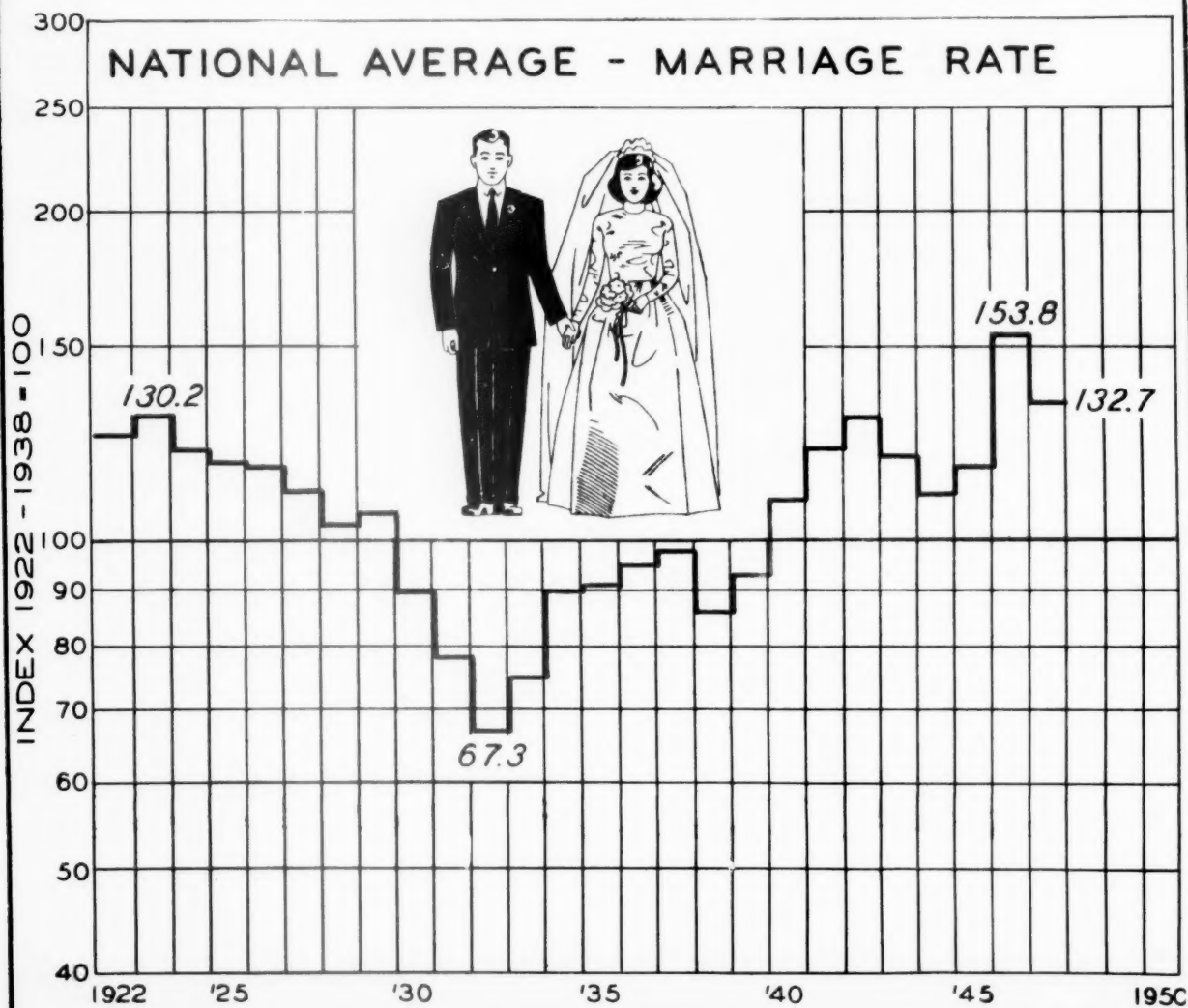
**N**O boom lasts forever, and no boom simply "happens." They are the result of many forces working through the nation's social and economic life, and as these forces take certain trends, real estate values rise or fall. Any discussion of the future course of real estate should, therefore, include a thorough analysis of these forces that accompany the ebb and flow of the real estate tides.

On the way into the last real estate depression, a surplus of housing gradually came into being. Families began doubling up, vacancies started mounting, and collections started dropping. Very little building was done. Residential construction fell from 937,000 nonfarm units in 1925 to 93,000 in 1933, while demolitions continued at a steady or increasing pace. As a result of construction inactivity, no new building mechanics were trained. It was folly to take on new apprentices when journeymen of long union membership were unemployed. The marriage rate took one drop after another as worsening business conditions caused marriages to be deferred. Back-to-the-farm movements developed. Because of unemployment, many families were forced to leave the large cities and return to rural communities. As the depression grew worse, these conditions became more intense - until the entire real estate industry and its allied industries were virtually paralyzed. Most of us remember this dreadful depression of the thirties all too vividly. Most of us would like to prevent another depression in the fifties.



On the surface, at the moment, there appears to be very little evidence to foster the fear of another depression. Mortgage activity is high, foreclosures are at an all-time low, and construction seems to be headed for a record year. In the face of such prosperity, there is real danger that the first warning will be regarded all too lightly. The chief messenger of bad news is the real estate activity cycle. The index of real estate activity so fondly regarded a few short years ago, when it was rising, has been sounding a cautionary note for the past two years.

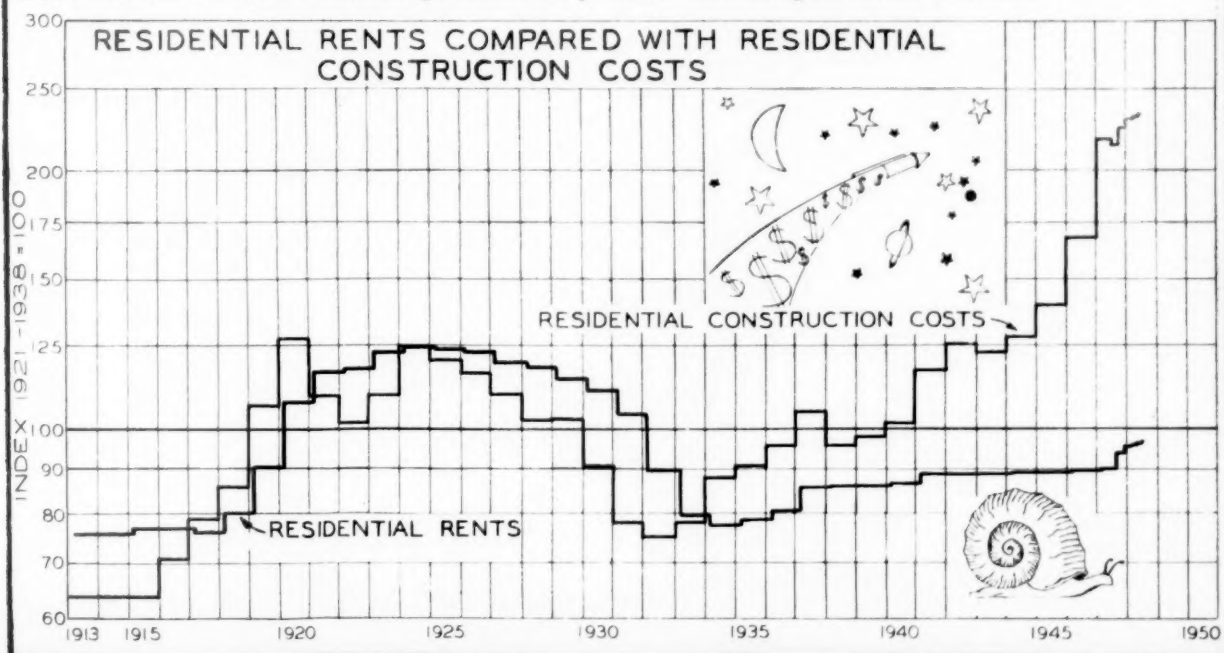
This is perhaps a very good time to take stock, analyze the factors that brought about this boom, try to find some basis whereby we can test their strength, and attempt to make a few guesses as to where and when the boom will end. To do this, we should go back to the bottom of the last depression. After practically every factor in the nation's economy touched bottom, general conditions began to improve slowly. Better business conditions provided bigger incomes and more employment. This resulted in an accelerated marriage rate and less doubling up of families. Families who had forsaken the cities for the farms began to move back. As business continued to improve, all of these factors began to operate faster - more and more marriages, more families undoubling, more families returning to the cities. As a result, vacancies began to disappear, rents began a slow rise, and the value of



existing properties began to increase. By 1940, even though a shortage of labor was becoming apparent, the construction industry had a fair-sized boomlet going, and by the end of 1941 as the tempo picked up and the pressure for more houses increased, construction costs began rising sharply. Then came the war, with its mass movements of families to centers of war production. This influx of people to our industrial areas accentuated the housing shortage and rent controls were applied early in 1942. By that time, the housing situation was becoming more serious - residential construction had slumped drastically (and was to fall still further) but marriages were still on the increase, and between 1941 and 1943 the population of the cities was swelled by over four million more people moving in from rural centers. The first effect of rent controls was the spreading out of nearly all-sized families. Space was scarce, but it was also cheap. Controlled rents administered the coup de grâce to residential vacancies.

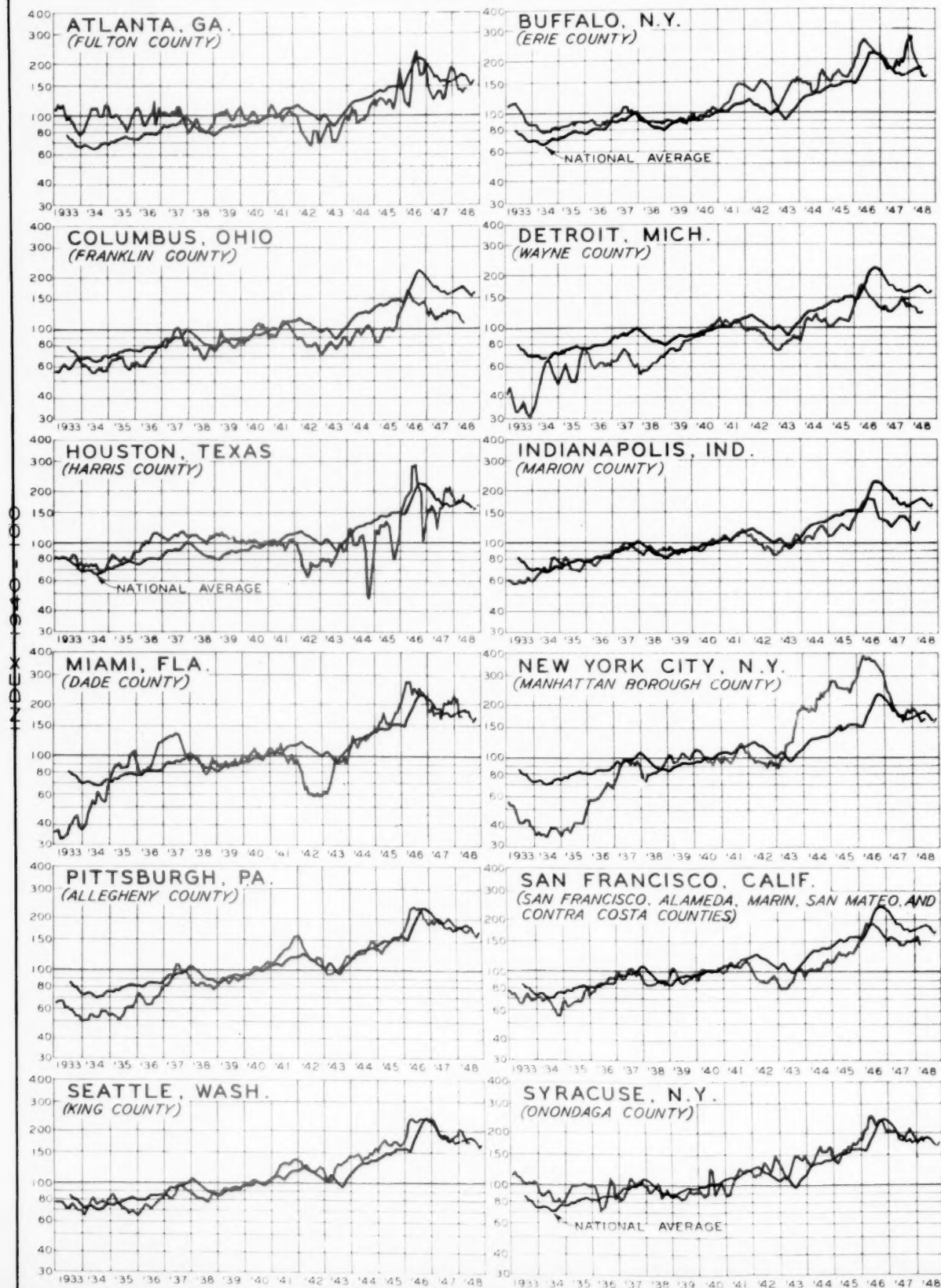
As the housing shortage became more rigorous and as residential construction came to almost a complete standstill, the normal tendency would have been for rents to rise. This natural reaction, prohibited by a war emergency measure, was supplanted by another natural reaction. Families in need of housing and with continually increasing earnings began to bid up the sales prices of existing housing. At the close of the war, real estate had climbed to approximately the same level it enjoyed in 1926. This activity, fed by increasing numbers of returning veterans and a rising marriage rate, grew to record-breaking proportions in 1946 and contributed absolutely nothing to the relief of the housing shortage.

Let us go back for a moment to the beginning of 1946 and recall what took place. It may help us appreciate the impact the returning veterans had on the real estate market. During the war thousands of servicemen and servicewomen were married, but by far the greatest majority of them were on active duty and were unable to enter the housing market. Thus the war created a situation within this group somewhat similar to the "marriage reserve" of the depression. The war also created a genuine "marriage reserve" of considerable proportions by causing many servicemen to defer marriage until they were discharged from service.



# REAL ESTATE TRANSFERS IN PRINCIPAL CITIES

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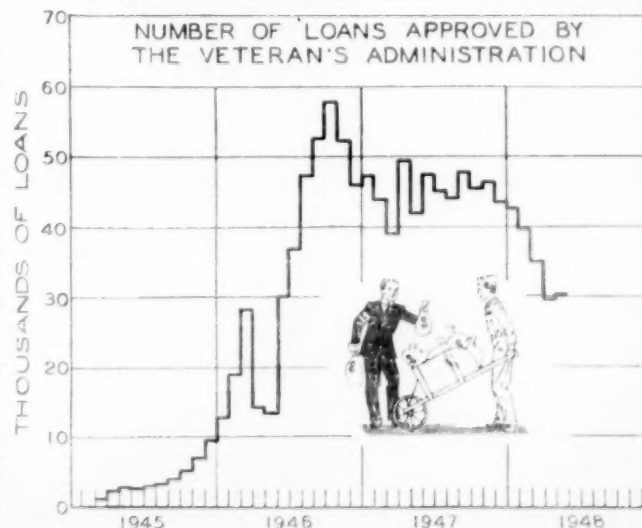
In 1946 shortly after the end of the war these two groups (the veterans who were married during the war and the veterans who were married as soon as they were discharged) entered the housing market backed by the GI Bill of Rights, the Veterans Administration and the FHA. It was these two groups that furnished the drive that sent the real estate activity index to a record high in May 1946.

Thus we see that the more immediate causes of the high rate of real estate activity and the rapid rise of real estate prices were rent controls and the multitude of new families which swarmed into the housing market in 1945 and 1946. Rent controls operated in two directions to remove rentable space from the market: 1. Frozen rents were an open invitation for more families to spread out into larger quarters. 2. Since rented space carried a "fixed" gross income and rising expenses, its net income and its value began to drop. In the midst of one of our worst housing shortages rented property - as such - was actually losing value. Faced with the prospect of several years of rent controls and increasing expenses, millions of owners of residential properties sold them. In the vast majority of these cases, the tenant was forced out and joined the ever-increasing number of families seeking housing in a constantly narrowing market. In 1945 and 1946 literally millions of discharged veterans and newly-formed families entered the search for housing. In most cases the veterans were aided in buying or building a home by GI and FHA loans.

The fact that this lending program was set up enabled a great many veterans to become home owners who ordinarily would not have been able to do so, and the stringencies of the rental market forced many veterans (as well as other would-be tenants) to do so reluctantly. Through May of this year, approximately 1,300,000 veterans had made application through the Veterans Administration for home loans. Of this total, 1,213,000 loans, amounting to almost \$7 billion, have been approved.

While these two factors - rent controls and the rapid formation of new family units - furnished the immediate drive for the boom, they were given unusual force by the existence of high incomes, large savings and easy financing. By the end of 1945, personal incomes had climbed to 101 per cent over the 1929 figure, and personal savings (for 1945) approximated \$29 billion (8 times the 1929 savings). In 1946, the first complete year of peace, personal incomes rose to 109 per cent above the 1929 figure, while personal savings for that year (1946) were around \$14.8 billion (4 times the 1929 savings).

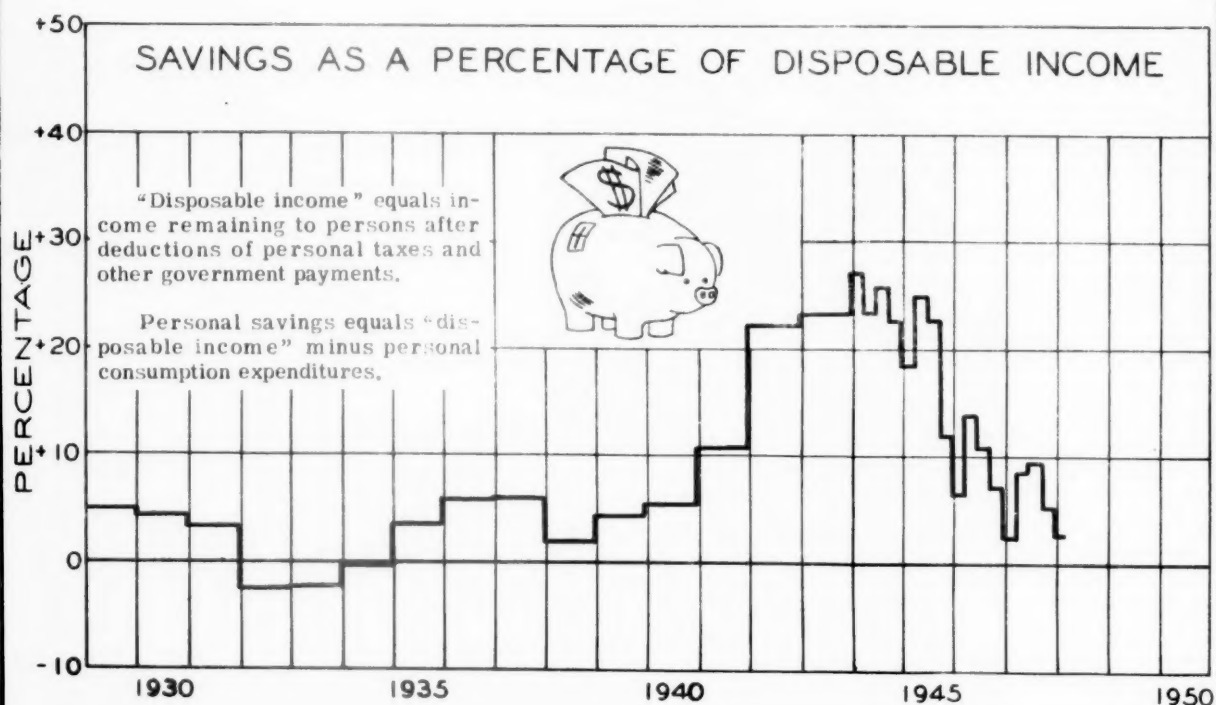
During 1945, 1946 and 1947, \$27.4 billion worth of mortgages were written on nonfarm homes of \$20,000 or less. This is more than double the total of the three years prior to our entry into the war (1939 through 1941 totaled \$12.2 billion). The present rate indicates that over \$11 billion more will be written in 1948. These figures understate the total somewhat due to the small amount of nonfarm



mortgages for over \$20,000. At the end of 1947 there were \$30.0 billion worth of mortgage loans outstanding on one- to four-family nonfarm homes, compared with \$13.2 billion in 1925.

"Easy financing" is a term more quickly applied than measured. It generally connotes low interest rates, generous appraisals, long terms, and low equities. How high and how low these various components have gone is very difficult to measure due to the lack of national statistics. During the past several years we have talked with hundreds of mortgage lenders regarding financing, and we have had the definite impression for some time that the days of easy lending have passed. One very good indication of this is the recent Congressional ruling that Title VI (lapsed for the time being), Sections 603 and 604 FHA loans be based on an appraised value of the property rather than on the "current costs" basis. Mortgage interest rates have been at almost record lows all during the boom. On page 285 we have charted the average interest rate of all mortgage loans in St. Louis from 1893 to the present. Notice the sharp upturn in the rate which took place in early 1947. Still another indication of stiffening lending policies is the drop in applications for GI loans which the Veterans Administration attributes partly to lenders' reluctance to finance at 4 per cent.

If we are correct in our assumption that the current boom sprang from these five factors: 1. Families increasing quicker than housing units; 2. Rapid assimilation of vacant rentable space brought on by rent controls; 3. High incomes; 4. Large savings; 5. Easy financing; let us examine them in more recent detail.



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Regarding the marriage rate and its effect on real estate, we quote from **THE COMING BOOM IN REAL ESTATE**, which described this situation in 1936:

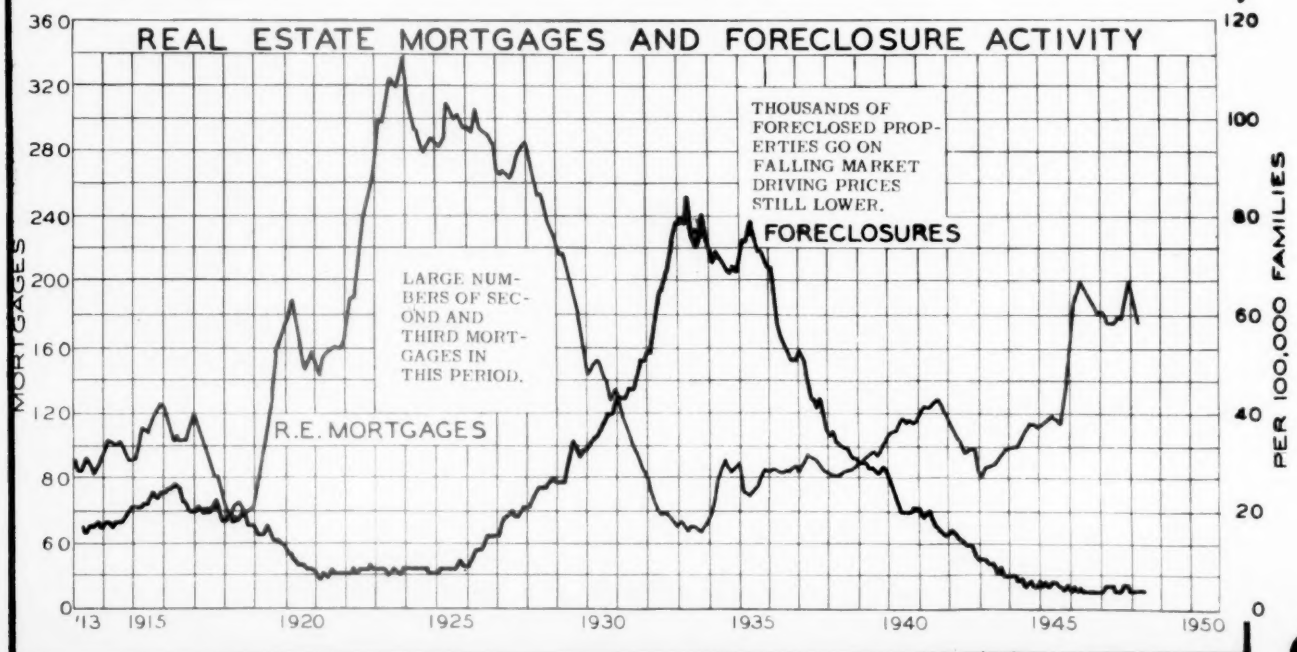
Delayed marriages are taking place.

Reference has been made to the acceleration of the marriage rate. The great importance of the marriage rate to real estate depends principally on the fact that in periods of depression and unemployment the marriage rate falls; and in periods of prosperity it rises, thus diminishing the demand for houses during the depression and increasing it rapidly as recovery takes place.

If these rises and falls in the marriage rate were slight, the effect on real estate would be negligible; but in a long and severe depression like the present one, the cumulative effect of a marriage rate more than 50 per cent below normal is tremendous.

It must be borne in mind that marriages are constantly being dissolved by death and divorce. Deaths of married persons occur in about the same percentage during depressions as they do during booms, and there are only slight increases in divorces during boom periods. In prosperous times the marriage rate will exceed the dissolution rate, but in drastic depressions dissolutions will exceed new marriages by such an amount that the number of families occupying homes shrinks rapidly, intensifying the already acute vacancy.\*"

\*The Coming Boom in Real Estate, by Roy Wenzlick. Simon and Schuster, New York City, publishers.



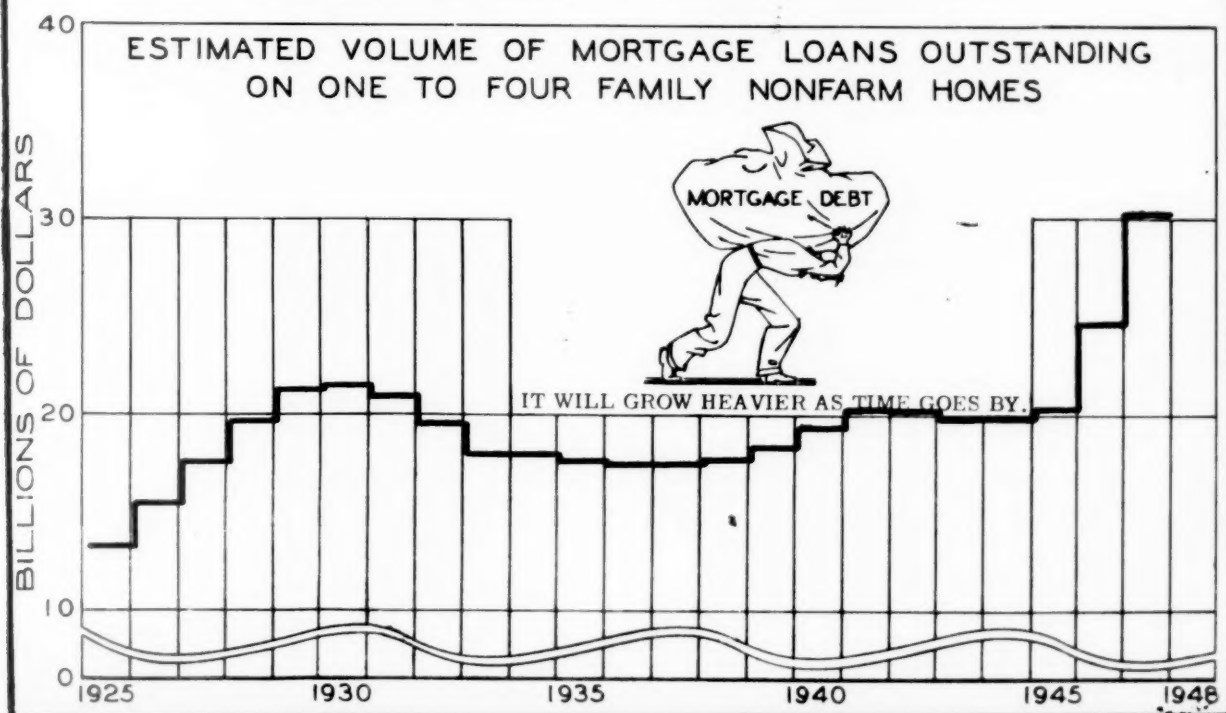
Since reaching its peak in 1946, the marriage rate has dropped 13.7 per cent in 1947 and 11 per cent in the first quarter of 1948. It is still above the 1922-1938 average and no immediate collapse is indicated. In fact, real estate activity, construction activity and the marriage rate do not collapse. They all three follow long extreme swings, rather closely related. During the last boom the marriage rate started down while construction activity was rising, but after two years of this divergence, construction activity fell off and started down. The marriage rate hit bottom in 1932, while construction activity receded until 1933.

In addition to the decline in the marriage rate the movement of people from the farms to the cities is much less than during the war and the stream of veterans being discharged into the housing market has dwindled to a mere trickle. This is not to imply that the housing shortage is over - there are still many families in search of housing - but we believe that the housing shortage, while most severe in many individual cases, has been overstated.

A nation-wide survey conducted recently by the National Association of Real Estate Boards confirms the fact that the housing shortage is less stringent. The survey reveals that 24 per cent of the 208 cities surveyed have reached a normal supply of used single-family dwellings, 21 per cent have reached a normal supply of new single dwellings, and 13 per cent now have a normal supply of apartment units.

Census figures are often improperly used in efforts to prove one thing or another regarding the housing situation. Unless the rather detailed definitions of the census reports are also presented with the figures, they can be very misleading. In April 1947 the Bureau of the Census estimated that there were 36,240,000 families in the United States. "Families" were defined in the following manner:

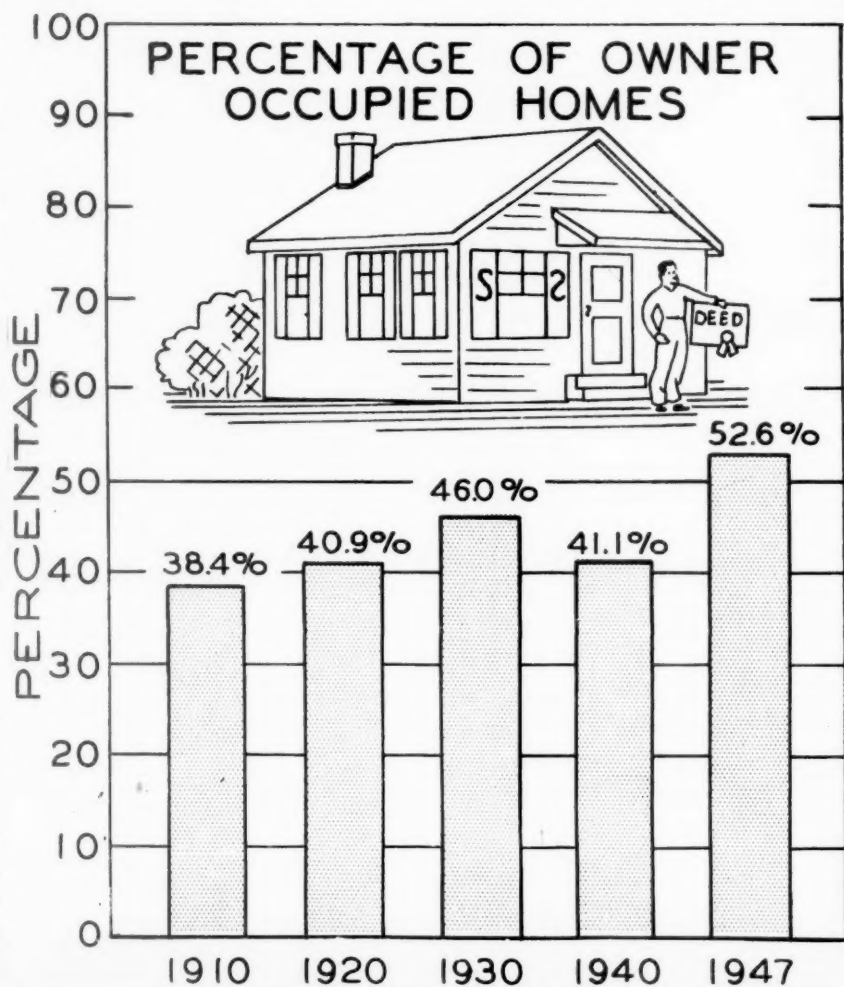
Family. -- The meaning of the term "family," as used here, is tentative and subject to revision. It differs from



the meaning of the term "family" as used in the 1930 and 1940 censuses. Comment is invited on any of the new concepts used in this report. The term "family" as used here, refers to a group of two or more persons related by blood, marriage, or adoption and residing together. A lodger and his wife who are not related to the head of the household, or an unrelated servant and his wife, are considered as a separate family, and not as part of the head's family. A household may therefore contain more than one family. All persons in a household who are related to each other are regarded as members of the same family. Thus, if the son of the head of the household and the son's wife are in the household, they are treated as part of the head's family. A household head living alone, or with unrelated persons only, is not regarded as a family.

Another report lists 39,138,000 "households" in the United States in April 1947. Various census reports show three different amounts for the number of households or families in 1940, all defined differently. Census figures on "doubling up" are often used to show the stringencies of the housing shortage. It is pointed out that 2,764,000 married couples were doubled up in April 1947. This is apparently meant to convey the impression that there is a demand for that much additional housing. In the 1940 census, however, it was revealed that 1,846,000 married couples were doubled up, and that there were nearly 2-1/2 million vacant dwelling units. Evidently a very large proportion of those couples doubled up in 1940 were doubled up by choice rather than by a shortage of housing. It, therefore, appears that "doubling up" statistics are very poor indicators of housing demand.

In studying the number of nonfarm families and nonfarm housing, the Bureau of the Census reports that in nonfarm areas the number of households increased 4,446,000 from 1940 through April 1947, and

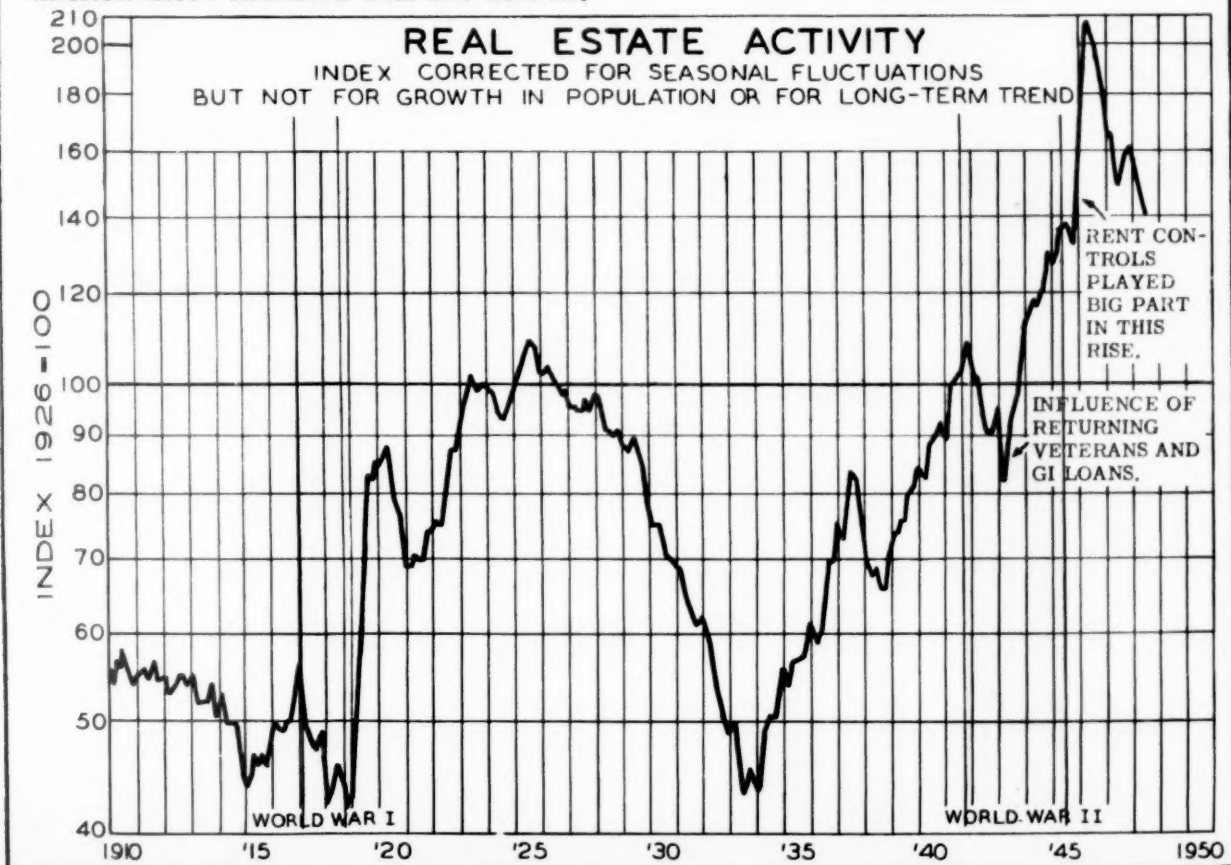


that during this same period the number of dwelling units in nonfarm areas increased 4,565,000. A household is defined as follows:

**Household** -- A household includes all of the persons who occupy a house, an apartment or other group of rooms, or a room that constitutes 'separate living quarters.' It includes the related family members and also the unrelated persons, if any, such as lodgers, servants, or hired hands who share the living quarters.

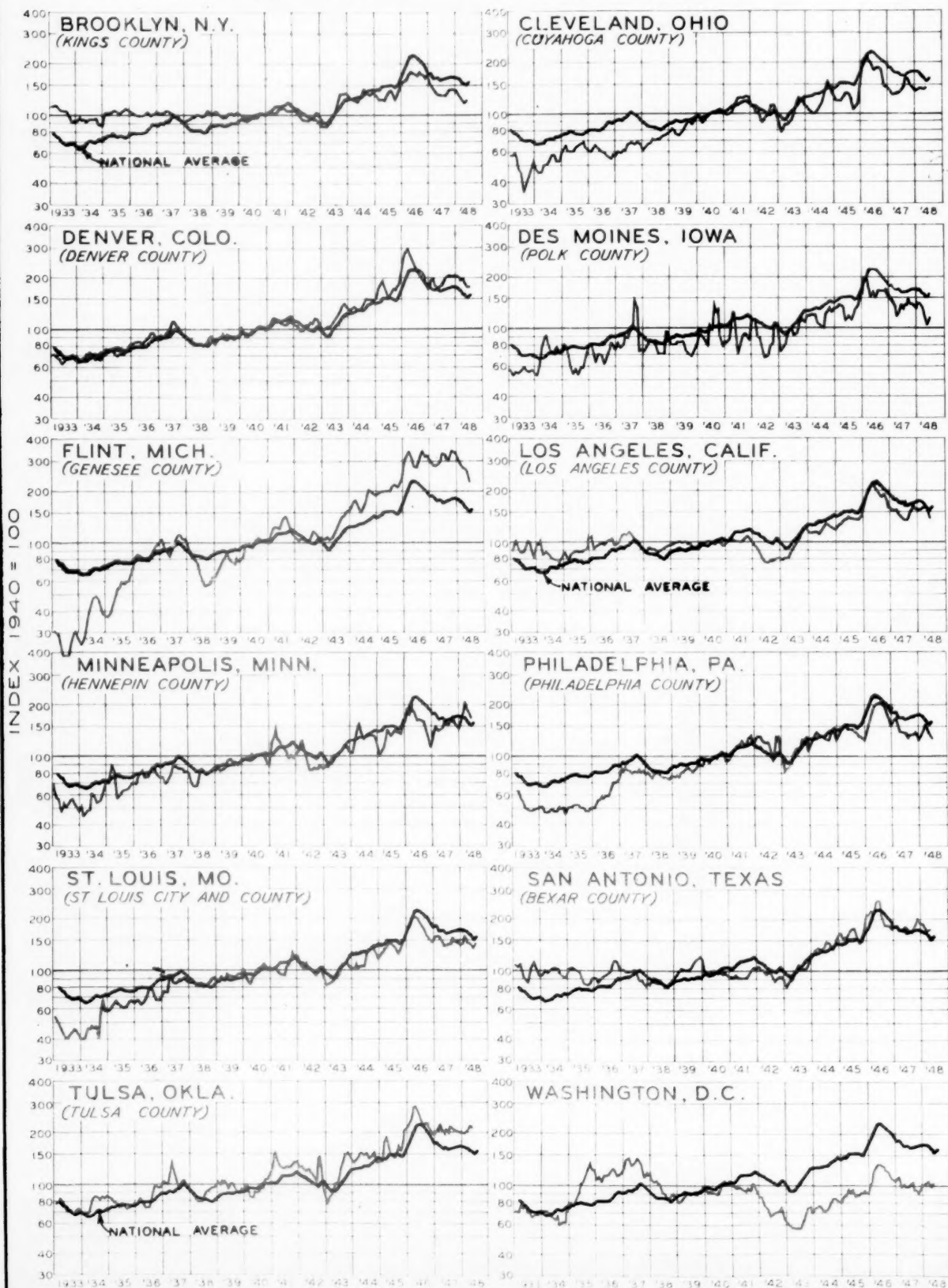
These figures cannot necessarily be interpreted at face value. The number of households obviously includes some "double up" families. At the same time, we have no way of knowing how many of these "double up" families would spread out if they had the opportunity. One conclusion that can safely be drawn is that the closeness of the two figures indicates that the construction of new dwelling units has very nearly approximated the formation of new family units.

For the past three years the Federal Reserve Bank has conducted a survey of consumer finances. In their most recent survey made in the early part of 1948, they reported that of approximately 3.5 million families who planned to buy a house in 1946, only 2.7 million did so and that this figure was inflated by the inclusion of lots and summer cottages purchased for future or part-time use. In 1947 approximately 2.7 million families expected to buy a house, and 2.2 million did so (40 per cent were veterans). The expected purchasers of houses in 1948 approximate 2.1 million, and if the preceding ratio prevails, somewhere in the neighborhood of 1.6 million more families will buy homes.



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Since the trend in these factors has turned down, we believe that the demand for housing is shrinking (not gone, but shrinking), and that this shrinking demand will be met more and more rapidly by increased construction activity. We believe also that even after vacancies begin to appear in larger numbers, residential construction activity will taper off over a period of several years instead of dropping suddenly.

It seems evident that the drive toward the boom furnished by rent control is diminishing. For one reason, rents are gradually being decontrolled and are slowly rising. For another, sales prices on older dwelling units are dropping. Most owners who have held their property through the high price period in hopes of decontrol are not apt to sell on a falling market now that rents are on the way up. We believe that rent controls will continue to be modified gradually and that in two or three years we may be rid of them entirely. The falling price level on existing units has decreased actively from another source also. While the market was rising, speculators accounted for quite a bit of activity, but since prices started dropping, the activity caused by speculators has come to almost a complete standstill.

With every rent rise, more families are forced into an economical use of space. This sometimes takes the form of doubling up and sometimes means moving to smaller quarters. So far, the rent rises have not been steep enough or often enough to cause much space economy. We believe that the eventual decontrol of rents will see possibly a million families move to small quarters or "double up." Most doubling up will be found among the 1-1/2 million individuals who live alone in rented units in our urban and rural nonfarm areas.

Indications are that high incomes will probably continue for some time in the future. On page 278, however, is a chart showing that the percentage of disposable income saved by individuals is responding to the increased flow of consumer goods coming into the markets. During the war lack of consumer goods and presence of high wages built personal savings up to an unprecedented height. Now incomes are

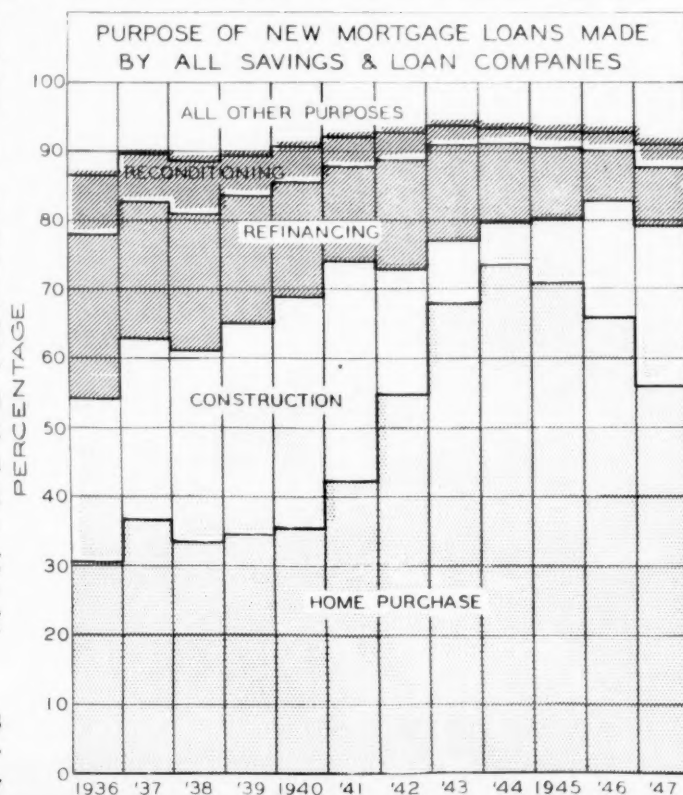


higher but such a flood of consumer goods is available that personal savings have fallen and installment debt is rising. The change in this situation shows that an important source of mortgage money is dwindling. Pinpoint predictions or statements regarding the amount of funds available for any particular purpose is very hazardous. Generally speaking, however, the consensus seems to be that while great funds are available, the over-all demand for these funds will exceed the supply. This will result in some tightening of credit (or will at least prevent looser terms) and a slow increase in interest rates. The ease of financing in the past few years has certainly overcome much of the public's resistance to high construction costs and high selling prices, but as credit tightens, interest rates rise, and appraisals become more conservative, a greater number of people will be forced from the market. One indication of the effects of tightening credit or tighter appraisals may be found in the chart on page 288 which shows that the percentage of second mortgage GI loans to total GI loans has risen from 3.9 per cent in February 1947, to 19.5 per cent in February 1948.

Just what the Federal government will do about the credit situation is not clear. We think that they will temporize and compromise and that the eventual action will be an attempt to keep the boom going without more inflation. This will prove to be a very delicate maneuver and no one can foresee what its outcome will be. One definite possibility is an increase in government-subsidized public housing projects.

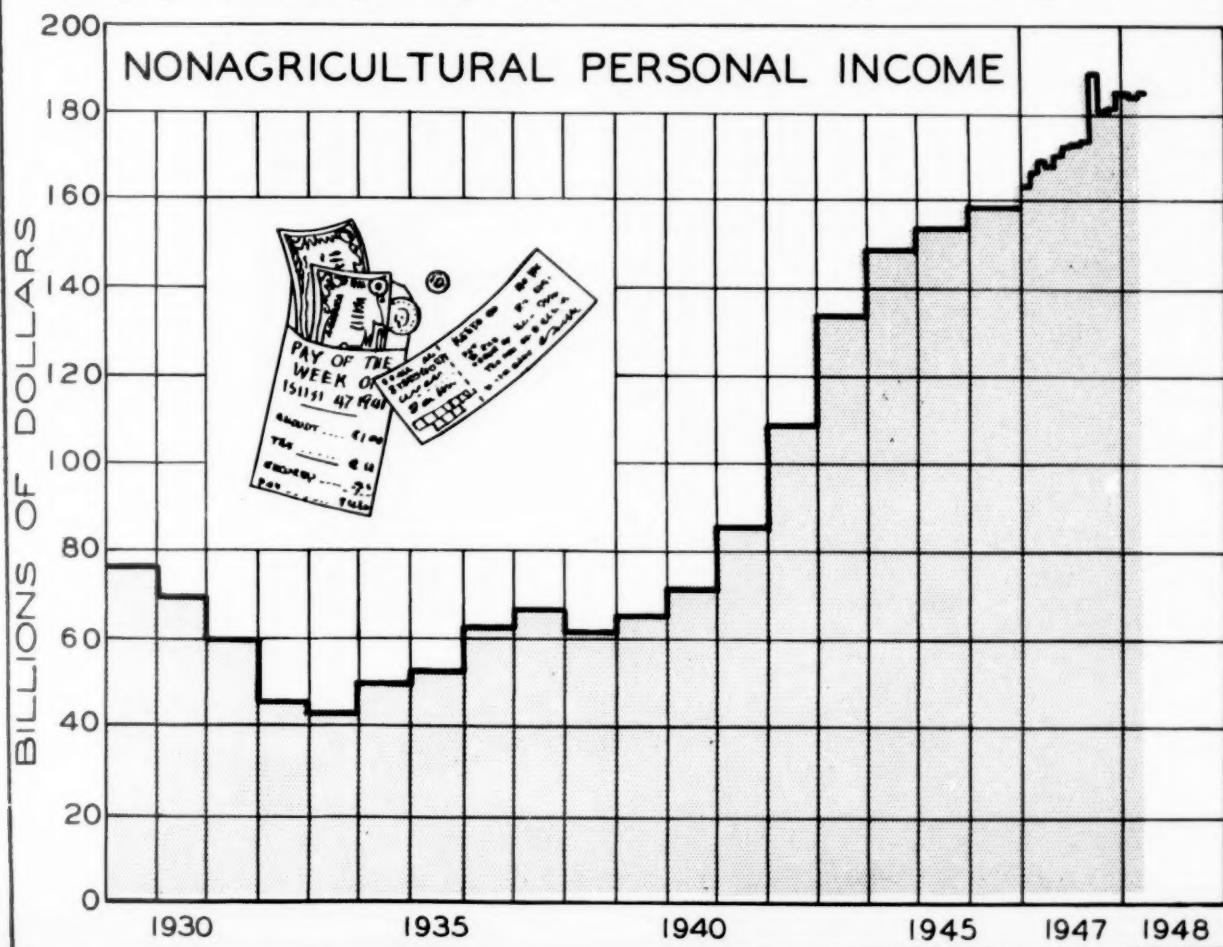
The purpose of all new mortgage loans made by savings and loan companies is shown in the chart on this page. We have already discussed the dropping trend in home purchases, and the increasing number of construction loans corresponds roughly with increasing construction activity. Loans for reconditioning and loans for "all other purposes," while always small in proportion to the number of construction and home purchase loans, have increased sharply since 1945. Reconditioning loans have risen from 2.1 per cent of the total to 3.4 per cent - an increase of 62 per cent, while loans for "all other purposes" (mostly to pay insurance and taxes) have risen from 7.2 per cent of the total to 9.0 per cent - an increase of 25 per cent. During the climbing stages of the boom, the proportion of these loans to the total number made was dropping. The increase in loans for "other purposes" signals that more people are having difficulty in keeping up their insurance or real estate tax payments, while the increase in loans for reconditioning implies that more owners are modernizing their homes in place of buying another one.

We may be wrong in our guesses regarding the future of real estate activity. The falling marriage rate may



reverse itself, credit may continue to be easier and easier to get, rent controls may become more stringent (bringing on higher demands for space), but our guess is that real estate activity and real estate prices are on the way down. There may be several short, false recoveries on the way, but the downward trend will continue. This does certainly not mean that all real estate all over the country will very suddenly go sour. So far, that has never happened, and there is no reason to believe that it will happen this time. The past experience has been for older types of residences to take the first dip; these are followed by more modern residences (less than 10 years old), then residential construction begins to slip as activity and prices of new dwellings start to slide. The later stages of the boom are usually characterized by high activity in larger apartments, office buildings and hotels, and brisk trading activity in nearly all types of property. As the boom continues to recede, construction slumps, costs go down, foreclosures increase, throwing more distressed properties on the market, and the depressed end of the cycle rolls around.

We do not believe that the next real estate depression will see prices shrink to their former low level. Our guess on replacement costs is that they will hit a low approximately 40 per cent above the 1939 level, and that selling prices of properties thirty years old or less will not go so low as they were in 1939. Insofar as activity is concerned, we believe that it will slide off more gradually than in the past few months and will dip across the normal line in about 1950. We have pointed out before that activity varies with geographic location. Of the individual cities making up our activity index, the peaks varied over a period of eight months.



Therefore, the end of the boom may come earlier in some cities than in others.

The years ahead promise a more difficult time for straight brokerage than for the construction or mortgage lending fields. All three will be sharply curtailed but we think that public works, including government-insured housing, will take up some of the slack in construction and mortgage lending. Another bit of rather chilly comfort may be found in the fact that dwindling activity will force hundreds of marginal brokers, mortgage lenders, and construction contractors into other lines of endeavor, while the hardier companies ride out the slack times in anticipation of the Boom of the Sixties.

